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WORLD TRADE ORGANIZATION

Committee on Balance-of-Payments Restrictions

REPORT ON THE 1995 CONSULTATION WITH THE SLOVAK REPUBLIC

1. The WTO and GATT 1947 Committees on Balance-of-Payments Restrictions consulted jointly with the Slovak Republic on 28 and 30 June 1995. The consultations were held under the Chairmanship of Mr. P. Witt (Germany) and in accordance with the terms of reference, pursuant to Article XII:4(b) of GATT 1994 and the Understanding on the Balance-of-Payments Provisions of GATT 1994. The International Monetary Fund was invited to participate in the consultation in accordance with Article XV:2 of GATT 1994.

2. The Committees had the following documents before it:

Basic document supplied by the Slovak Republic	WT/BOP/3
Background paper by the Secretariat	WT/BOP/W/5
Notification by Slovakia under paragraph 9 of the Understanding on the Balance-of-Payments Provisions of GATT 1994	WT/BOP/N/1

Opening Statement by the Representative of the Slovak Republic

3. The opening statement of the representative of the Slovak Republic is attached as Annex I.

Statement made by the Representative of International Monetary Fund

4. The Statement made by the representative of the International Monetary Fund is attached as Annex II.

Discussion in the Committees

(i) Balance-of-payments position and prospects; alternative measures to restore equilibrium

5. Members of the Committees noted that the Slovak economy had recorded a significant improvement in 1994 as the reform process began to bear its fruit. The results achieved on the external account had surpassed all expectations. The hope was expressed that, with the restructuring of the economy, domestic demand would increase, which, in turn, would induce an increase in imports of investment goods, essential to the modernisation of Slovakia's production capacity and competitiveness. Members had doubts regarding the Slovak view that a change from an export led-growth to a more balanced growth pattern would necessarily lead to balance-of-payments problems. Uncertainties caused by low competitiveness, reversibility of capital flows were quasi-permanent features of the transition

process and not only inherent to the Slovak economy. The recourse to balance of payments restrictions, therefore, could not be considered the optimum policy response.

(ii) System, methods and effects of import restrictions

6. Members of the Committees stated that, based on the strong performance of the Slovak economy and the favourable balance-of-payments position in 1994, the rationale for maintaining the surcharge could not be substantiated. Continued recourse to the balance of payments derogation, therefore, no longer appeared to be justified. Recalling the conclusion of the Report of the GATT 1947 Committee on the 1994 consultations with Slovakia (BOP/R/218), Members expressed regret that Slovakia had not adhered to its declared intention to eliminate the surcharge by the end of 1994 and that the present time-table for the phase out extended the elimination of the surcharge beyond the end of 1995. Furthermore, Members questioned whether the removal of the surcharge would have a significant effect on the balance-of-payments situation, given that surcharge had been imposed only on 13 per cent of total imports in 1994. Members of the Committees stated that Slovakia should eliminate the surcharge as soon as possible and resort to the relevant provisions of GATT only in case of severe balance-of-payments difficulties.

(iii) Replies by the Slovak Republic

7. The representative of Slovakia stated that pursuit of prudent monetary and fiscal policies should lead to sustainable growth. However, the balance-of-payments situation remained fragile: Export-led GDP growth in 1994 was exceptional and the trade balance might worsen as a result of the increase in imports observed in 1995. Privatization was the driving force in the restructuring of the national economy from the present heavy industry to high technology production. Because of the low rate of domestic savings, Slovakia would need to mobilize additional external resources to accelerate privatization and infrastructure development. Future commitments related to external borrowing might also alter the balance-of-payments position.

8. The representative of Slovakia also stated that the surcharge was imposed for balance-of-payments purposes and not to remedy a fiscal problem. It would be maintained in 1995 and would be removed by the end of 1996, provided the balance-of-payments position remained satisfactory.

Conclusions

9. The Committees commended Slovakia on its economic achievements in the last year. They noted that since the last consultation, Slovakia's macroeconomic situation had improved markedly, with export-led GDP growth of 4.8 per cent, significant fiscal consolidation, slightly reduced unemployment, a halving of inflation to 11.7 per cent, substantial surpluses on both current and capital accounts and a rise in official reserves to almost three months' imports of goods and services. The Committees hoped that these positive developments would continue.

10. The Committees noted that, notwithstanding these developments and the Slovak authorities' declared intention to eliminate the 10 per cent import surcharge by the end of 1994, the surcharge had been extended for 1995 and that Slovakia had informed the Committees that it would be phased out only during 1996 provided that the balance-of-payments position remained satisfactory. Slovakia confirmed that it did not apply any non-tariff trade barrier for balance of payments purposes.

11. Slovakia expressed its concerns regarding the adverse effect of an early abolition of the surcharge on the long term stabilization of the balance of payments, bearing in mind the potentially unsustainable development of the trade balance, the need to meet foreign debt service obligations, the introduction of current account convertibility and the possibility of securing the resources necessary for the restructuring of the economy. The Committees restated their view, expressed in the previous consultation with Slovakia, concerning the harmful effects on resource allocation resulting from the prolonged application of an import surcharge.

12. Given the favourable developments in Slovakia's economic performance, the Committees regretted that the Slovak Republic had not adhered to its declared intention to eliminate the surcharge by the end of 1994. The Committees stressed that, under Article XII of GATT 1994 and the related Understanding, trade measures were to be used only in the case of severe balance-of-payments difficulties. They repeated that surcharges should not be used for fiscal or protective purposes.

13. Recognizing the improved economic and balance-of-payments situation, the Committees requested Slovakia to eliminate the import surcharge by the end of 1995, if possible, but in any case before 30 June 1996.

ANNEX I

Opening Statement by the Representative of the Slovak Republic

1. On behalf of the Government of the Slovak Republic, let me thank you for the opportunity to present our position on the implementation of the import surcharge. The Slovak Government is aware of the great importance of this discussion and wishes to inform the Committee members about the reasons for its continuous application.

2. A temporary import surcharge is applied by the Slovak Republic since 3 March 1994 in order to assist in remedying the balance-of-payments situation and foreign exchange reserves.

3. The consultations in the Committee on Balance-of-Payments Restrictions, were held in July last year. The Slovak Republic notified the extension of the application of the import surcharge in Document WT/BOP/N/1.

4. When introducing the import surcharge the Government of the Slovak Republic declared the short period of its application and stated the objective to repeal it by the end of 1994. However, some elements had been underestimated and neglected and have been influenced by the expected development in the debt-payments, the development in the payment agreement with the Czech Republic, the impact of the introduction of the current account convertibility of the Slovak koruna, as well as other possibilities in export and the massive imports in reviving the industrial production.

5. The main reasons which have led the Slovak Government to continue the application of the import surcharge also in 1995 can be summarized into four basic groups:

1. the unsustainable development in the trade balance and balance of payments
2. new payment conditions with the Czech Republic
3. the intention to introduce the current account convertibility
4. the debt calendar and debts services

6. The development of foreign trade in 1994 represented one of the stabilizing and dynamizing factors in the economic development. Preliminary results of the trade flows show in 1995 that the exports and imports according to the official data are very volatile. While in March and April a surplus in the trade balance was reached, in January, February and May a deficit was recorded.

7. Despite the import surcharge the imports rose in 1994 by 8.4 per cent in comparison to 1993. This trend continues also in 1995 when the imports during the first five months have risen by 24 per cent.

8. Moreover, a detailed examination of the import structure shows that due to the tight monetary and restrictive fiscal policy, and due to the efforts of the Slovak Government to raise and stabilize the foreign exchange reserves, minimum investment imports were realized during the past year and imports were concentrated mostly to the consumption goods and goods for further re-processing.

9. After the real GDP increase in 1994 by 4.8 per cent in comparison to 1993, the trend continues also in the first months of 1995. This positive development will on the other hand also increase the domestic demand and the pressure on more investment imports. This change in the import structure could also have the impact on the foreign exchange reserves.

10. Looking at the country structure of our imports it can be seen how deeply the Slovak economy is dependent on the imports from Russia. The trade balance deficit with Russia reached last year almost US$900 million and this trend continues also in 1995. During the first five months of this year the deficit has reached US$474 million which is US$100 million higher in comparison with the last year. It shows that the overall trade balance is very dependent on and influenced by our exports to Russia since the imports represent the main raw materials, as gas, oil, coal and others which are inevitable for the whole economy.

11. After the split of the former Czech and Slovak Federal Republic, for both countries, the Slovak Republic and the Czech Republic, it was necessary to solve the problem of the settlement system. In February 1993 Slovakia introduced its own monetary system. In order to maintain the traditional trade flows and trade relations the countries decided to establish the clearing account with 130 million ECU. The Slovak Republic devalued the clearing ECU by 5 per cent on 7 December 1993 and revalued the Slovak koruna in relation to the clearing ECU by 4 per cent on 19 May 1995, in accordance with the provisions of the Payment Agreement.

12. During two years of the functioning of the clearing account it may be assessed that the clearing account contributed to the smooth establishment of the payment system. It would be very difficult to estimate the impact of trade flows and the need for the foreign exchange reserves after introducing the new system based on hard currency. Definitely we will lose the "pillow" in our mutual trade which was represented by 130 million ECU.

13. The Slovak Republic is interested in introducing the deregulation of its own foreign exchange system. In order to prepare conditions for accepting Article VIII of the Articles of Agreement IMF, especially paragraphs 2,3 and 4 and to introduce full current account convertibility, a new payment system between both countries will be introduced as from September 1, 1995. Both elements are a new phenomenon for the Slovak economy and therefore it will be very difficult to predict the impact on balance-of-payments development after 1 September.

14. By preparing conditions for current account convertibility, the National Bank of Slovakia increased the limit of foreign exchange for natural persons to the amount of US$500 per year and this limit will be further increased as from 1 July 1995 up to US$1000 in the course of the following years, which could also have an impact on the foreign exchange reserves.

15. Finally, let me touch on the external position of the Slovak economy. The total gross foreign debt for the Slovak Republic represented at 31 December 1994 US$4.3 billion. The gross foreign debt increased by US$603 million in 1994. The debt service, i.e. the paid foreign obligations (excluding payments to the IMF) amounted to US$ 234.6 million in 1994. Foreign obligations due in 1995 will be even higher than 1994, for the total value of due obligations including payments to the international financial institutions is estimated to be US$520 million. According to the instalments calendar the highest burden for repayment debt services will be during the years to come, especially in 1996 and 1997.

16. The aim of the Government is to achieve a sustainable economic growth. The Government stated in its programme the priorities in the macroeconomic performance (growth of GDP, reduction

of the inflation rate, reduction of the unemployment rate, improvement of the foreign exchange reserves, sustaining the exchange rate of the Slovak crown and the introduction of full convertibility of the Slovak crown on current account), which influenced the Government decision to apply the import surcharge in 1995 and 1996.

17. The import surcharge is applied to consumer goods and foodstuffs at a level of 10 per cent. The customs value is used as the basis for determining the amount of surcharge to be paid. The import surcharge is applied in a non-discriminatory manner to all imports irrespective of the source of supply.

18. The surcharge is applied to an extent necessary to achieve the stated aims and priorities of the Government. It is transparent, and it fulfils the basic conditions of consistency with the relevant Articles of the WTO namely the Article XII of GATT 1994. The broad spectrum of items to which this measure applies, is sufficient evidence that the Slovak Government is not pursuing protection of a certain branch, or product, or group of products.

19. Before concluding, May I reassure you, Mr Chairman, and all the members of the Committee and other WTO members that the import surcharge does not imply a departure from the generally liberal line of Slovakia's trade policies. The Slovak Republic has implemented as from 1 January 1995, all commitments resulting from the Uruguay Round. Slovakia belongs to those countries with one of the lowest weighted average tariff protection of 4.9 per cent which will change after implementing the results of the Uruguay round to 3.8 per cent including 100 per cent comprehensive tariff binding.

20. The application of the import surcharge during the last fifteen months showed some positive impact, to be observed in the improvement of the macroeconomic position. However, an early abolition under given circumstances could reverse the situation in the balance of payments and in the foreign exchange reserves. From this point of view the Government considers that the external balance-of-payments position is very vulnerable and fragile.

21. Therefore, with regard to the expected development of these factors the Government intends to reduce the import surcharge by the end of 1995 to 7.5 per cent, and gradually to decrease from 1 July 1996 to 5 per cent, from 1 October 1996 to 3 per cent and to remove it by the end of 1996, provided the balance of payments position remains satisfactory.

22. Finally, I wish to thank you, Mr. Chairman, for the opportunity to consult with the Committee, the continued application of the import surcharge. I hope that after explaining our difficult position in introducing other macroeconomic measures the Committee will have the understanding for the further introduction of the import surcharge.

23. I and my colleagues are prepared now to respond to questions and comments which may arise during the discussion.

ANNEX 2

Statement by the IMF Representative at the 1995 Consultation with the Slovak Republic

Over the past 2 1/2 years, the authorities of the Slovak Republic have met with considerable success in their efforts to build a new state, manage the transition to a market economy, and correct the macroeconomic imbalances.

As of end-1993, Slovakia's performance was still worrisome: real output, which had declined by 25 percent since 1990, showed no signs of recovery; inflation and the current account deficit were high; foreign reserves were low; and the fiscal deficit was unsustainable.

Results for 1994 stand in sharp contrast to that situation. Led by an export boom, real GDP rose by 5 percent, the external current account swung into a surplus equivalent to 6 percent of GDP, and official foreign exchange reserves almost quadrupled to reach the equivalent of 2 1/2 months of imports of goods and services by end-1994. Meanwhile, inflation was halved to 12 percent. This performance was supported by prudent financial policies. The fiscal deficit declined by 5 percentage points to 2 1/2 percent of GDP, while monetary policy struck a proper balance in sterilizing large foreign exchange inflows.

Economic performance continued to be favorable in early 1995. The 12-month inflation rate fell to 11 percent in May relative to 14 percent a year earlier. Unemployment has been slightly lower than a year ago and industrial production during the first quarter was 7 1/2 percent higher than in the first quarter of 1994. With continued export growth during the first five months of 1995, official foreign exchange reserves rose further by US$0.3 billion to US$2.0 billion at end-May 1995.

The export-led recovery points to considerable economic restructuring. The foundations of this were laid under the federation, notably through liberalization of the price, exchange and trade systems, privatization (small establishments and "first wave" of large units), and initial steps toward financial reform. Structural reform, especially privatization, slowed after independence, reflecting in part administrative constraints and frequent political changes. Nevertheless, the establishment of the essential market mechanisms and of hard budget constraints on enterprises as a result of tight financial policies enabled and, indeed, fostered adjustment and economic transformation at the micro level. However, restructuring has not involved large new investments for modernization or expansion, and real fixed investment declined substantially in 1994. The extent of the transformation is apparent from the fact that the private sector's contribution to GDP rose to almost 60 percent in 1994, compared to one third in 1992.

Slovakia inherited from the Czech and Slovak Federal Republic (CSFR) a substantially liberalized trade and payments system. Import licenses are required only for a few items (crude oil, natural gas, firearms and ammunition, narcotics, coal, uranium, and waste paper). Export licensing is limited to situations related to security and health control, to preservation of natural resources and strategic inputs, and to implementation of voluntary export restraints when quotas by importing countries exist. Slovakia maintains a bilateral payments agreement, clearing arrangement and custom union agreement with the Czech Republic, an Association Agreement with the EU, and free trade agreements with Visegrad and EFTA countries.

Slovakia's average import tariff is relatively low (6 percent on an unweighted basis). However, in March 1994, while the external position was still weak, the Government introduced a 10 percent surcharge on imports of consumer goods that was to be eliminated by end-1994. In the event, the new Government decided to maintain the import surcharge citing concerns about the effects of its early elimination on the budget, and the sensitivity of the balance of payments to expected modifications to the clearing account with the Czech Republic. The authorities now envisage eliminating it only by end-1996--and as an intermediate step to reduce it to 7 1/2 percent at end-1995--provided that the external position remains favorable. They expected that the effect on the budget of the phasing out of the import surcharge would be offset by containing growth in expenditures in 1996-97 (the annual yield of the surcharge is estimated at about 1.4 percent of general government revenue or 0.7 percent of GDP).

Slovakia's external outlook has considerably improved over the past year reflecting the strong export performance and rapid growth of foreign reserves. Good economic performance and relatively low external indebtedness have ensured Slovakia's access to private capital markets and improved Slovakia's sovereign credit rating. The authorities have thus reiterated their desire to achieve full current account convertibility during 1995 and to adopt the obligations of Article VIII of the IMF Articles of Agreement no later than January 1, 1996. In preparation for this step, a new Foreign Exchange Law has been drafted and is to be adopted in the third quarter of 1995. They also intend to eliminate the discriminatory features of the bilateral payments agreements with the Czech Republic. [1] Indeed, effective May 19, 1995 the NBS revalued the Slovak koruna by 4 percent under the payments agreement, thereby erasing most of Slovakia's 5 percent devaluation vis-à-vis the Czech koruna in December 1993. The authorities have also indicated their intention to relax restrictions on the capital account; however, the scope and timing of these measures are still under study.

In summary, the authorities have made important progress in restoring confidence through fiscal tightening, reducing inflation, and strengthening the external position. Looking forward, the authorities aim to consolidate these achievements through further reduction in inflation to single-digit levels, additional improvement of the external position, and reinvigoration of structural reform so as to ensure sustainable high growth. Against the background of continued strong external performance, the Fund welcomes the authorities' intention to attain full current account convertibility by January 1, 1996; but regrets their decision to continue the import surcharge until end-1996 and urges that it be phased out by end-1995.

[1] The Czech Government recently indicated its intention to seek termination of the bilateral payments agreement before end-1995.